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IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

No. 909

WALTER E. MEYER, Intervener,
Petitioner,

v.

BERRYMAN HENWOOD, as Trustee of St. Louis Southwestern Railway Company Lines, *et al.*,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

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NOTE

The following railroads are sometimes referred to as follows:

St. Louis Southwestern Railway Company as the "debtor", "St. Louis Southwestern", or "Cotton Belt."

Southern Pacific Company as "Southern Pacific".

The Chicago, Rock Island and Pacific Railway Company as "Rock Island".

St. Louis-San Francisco Railway Company as "St. Louis-San Francisco" or "Frisco".

Kansas City Southern Railway Company as "Kansas City Southern".

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BERRYMAN HENWOOD, as Trustee of St. Louis Southwestern Railway Company Lines, *et al.*,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

TO THE HONORABLE THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioner respectfully shows:

Statement of Matter Involved

Petitioner files this petition in behalf of himself and other stockholders of debtor, St. Louis Southwestern Railway Company.

The debtor owns and operates a railroad system extending from St. Louis and Memphis to points in Texas and Louisiana.

The road has been in reorganization since December 1935 (R. 91).

Hearings were held by the Interstate Commerce Commission in connection with the formulation of a plan of reorganization in March and April, 1937 and May and September, 1939 (R. 3497). The report of the Commission was rendered on June 30, 1941 (R. 3495); its supplemental report on March 9, 1942 (R. 3736).

Petitioner's charges

The Commission, in making its estimate of prospective earnings of the debtor for the purpose of determining capitalization in the plan of reorganization, took the record of earnings of debtor for the years 1927 to 1936 (R. 3503, 5574), and subsequently extended this period through the first six months of 1941 (R. 3690-1, 3740-1, 5574).

It is the position of petitioner that the record of earnings thus taken is a record impaired by illegal control of the debtor by successive railroads, beginning in 1925, in breach of the fiduciary and other obligations of these railroads to debtor, and in violation of the antitrust laws; and that the real earning power of the debtor is much in excess of that shown by its record of earnings, and justifies and requires a plan of reorganization providing in full for all security holders and creditors.

An equally important issue arises out of the fact that the Commission in its plan failed to subordinate the interest of Southern Pacific Company, a large creditor and stockholder, despite its wrongful and unlawful acts and failure to act in its relations with debtor both previous to and since its acquisition of stock control in 1932.

The Commission devoted the greater part of its report (R. 3547-3678) to a discussion of the proof introduced by petitioner in support of his charges, and found that said

proof was not sufficient to sustain the charges.* It is because of the failure of the District Court to review and the inadequate review by the Circuit Court of Appeals of the findings and conclusions of the Commission in respect to the said proof that petitioner, among other reasons, prays this Court to grant this petition.

It is therefore desirable to make a brief statement of some of the more salient facts underlying these charges:

Control of debtor by competitors

Up to March, 1925, Edwin Gould, a son of Jay Gould, held a dominant stock interest in debtor.

On March 11, 1925, the Chicago, Rock Island & Pacific Railway Company acquired Edwin Gould's interest. This stock, together with stock held by interests friendly to Rock Island, gave that road control of debtor (R. 5578, 3011).

Thereafter, Rock Island applied to the Commission for authority to acquire stock control of the debtor. The Assistant Director of the Bureau of Finance of the Commission in a proposed report recommended that the application be denied. He found that Rock Island was a competitor of the debtor, and admonished Rock Island for its exercise of control over the debtor without the authorization of the Commission (R. 3008-3017).

In October, 1925, Rock Island sold its dominant stock interest in debtor to the Kansas City Southern Railway Company (R. 5578). The stock thus acquired, together with the stock acquired by the latter's banking advisers, Kuhn, Loeb & Company and Ladenburg, Thalmann & Company, amounted to over 51 per cent of debtor's stock (R. 3576). The Kansas City Southern is also a competitor of debtor.

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* Chairman Eastman wrote a dissenting opinion (R. 3713-3732).

In July, 1926, Kansas City Southern applied to the Commission for authority to acquire stock control of the debtor and Missouri-Kansas-Texas Railroad (a competitor of Kansas City Southern and the debtor), which road Kansas City Southern at the time also controlled without the authorization of the Commission. The Commission in 1927 denied the applications for unification of the three roads (*Unification of Southwestern Lines,* 124 I. C. C. 401).

In its report the Commission held that the control over debtor and Missouri-Kansas-Texas by Kansas City Southern without the authorization of the Commission "constituted violations of section 7 of the Clayton Antitrust Act and perhaps also of the Sherman Act" (*id.,* at p. 430, R. 5441-5444, 5578).

The Commission also pointed out the danger to minority stockholders of debtor by the illegal control thus exercised by Kansas City Southern, through impairment of debtor's earnings by diversions of traffic, and deterioration of its property and service to patrons. "By these methods", said the Commission, "the price of the stock of the controlled carrier can be depressed and its acquisition by the controlling carrier or its stockholders facilitated" (*id.,* p. 433, R. 5444).

In 1928, at petitioner's request, the Commission brought proceedings under the Clayton Act against the Kansas City Southern to compel it to divest itself of its stock interest in the debtor and Missouri-Kansas-Texas (R. 3581).

On April 15, 1929, while the said proceedings were pending, a syndicate composed of New York Investors, Inc., its President and Chairman, and others, acquired Kansas City Southern's stockholdings in the debtor. Leading members of the said syndicate had previously actively participated in the illegal control exercised by Kansas

City Southern over debtor and Missouri-Kansas-Texas. In the opinion of Commissioner Eastman and other minority members of the Commission, the said transaction was collusive and served to continue Kansas City Southern in control of debtor. (*Interstate Commerce Commission* v. *Kansas City Southern*, 156 I. C. C. 359, 363-366, R. 5446-5452, 5579.)

Petitioner showed that data for the years 1924 to 1927 compiled by Kansas City Southern, Missouri-Kansas-Texas and debtor at the request of the Bureau of Inquiry of the Interstate Commerce Commission in connection with said Clayton Act proceedings, proved incontrovertibly that traffic in large amounts was diverted from debtor to Kansas City Southern and Missouri-Kansas-Texas during the period 1925 to 1927 (R. 1727-1787, 3472-3481).

Petitioner further showed that during the period of illegal control from 1925 to 1932, in comparison with four other railroads, competitors of debtor—the Kansas City Southern, Missouri-Kansas-Texas, Missouri Pacific and St. Louis-San Francisco, operating in the Southwestern Region, debtor failed to hold its own and suffered a loss in freight revenues of $27,626,157 (R. 3253-3257, 5583) and in earnings in the amount of $18,787,152 (R. 3260-3262); and that in comparison with the railroads of the Southwestern Region as a whole debtor failed to hold its own in freight revenues in the amount of $23,676,728 (R. 3257-3258).*

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* The "Southwestern Region" is described in the *Statistics of Railways of the United States* published by the Interstate Commerce Commission in 1935 as follows: "This region comprises the section lying between the Mississippi River south of St. Louis and a line from St. Louis to Kansas City and thence to El Paso and by the Rio Grande to the Gulf of Mexico."

Control by Southern Pacific Company

Debtor's preferred stock outstanding amounts to 198,936 shares and its common stock to 171,861 shares.

During the period 1929 to 1932, in which debtor was controlled by the aforesaid syndicate, Southern Pacific began to accumulate stock of the debtor. By April 1930, Southern Pacific had acquired 42,600 shares of the common stock. On July 15, 1930, it purchased outright from the syndicate 87,200 shares of preferred stock and entered into an agreement with Kuhn, Loeb & Company, who acted as intermediaries, to purchase from them 59,380 shares of preferred and 24,700 shares of common stock. In all, the above constituted about 57% of debtor's stock (R. 5579).

In the same month, July 1930, Southern Pacific filed its application with the Commission for authority to acquire stock control of debtor, and placed two of its officers on the board of directors. The application was granted, and on April 14, 1932, that company entered into formal control of debtor. (*St. Louis Southwestern Ry. Co. Control,* 180 I. C. C. 175; R. 3588, 3589.)

Acquisition of control gave the lines of Southern Pacific an increased haul from Corsicana, Texas, its most important point of interchange with debtor, to St. Louis, of over 700 miles (R. 1085, 5342).

In connection with its acquisition of debtor's stock, Southern Pacific made a cash investment of $19,493,589 and also exchanged 49,110 of its shares for stock of the debtor. By 1933 Southern Pacific's holdings amounted to 87.37% of debtor's entire stock (R. 5579). In June 1932 Southern Pacific guaranteed the loan by the Reconstruction Finance Corporation to the debtor in the amount of $17,882,250 (R. 851; *St. Louis S. W. Ry. Co. Reconstruction Loan,* 184 I. C. C. 74, 83).

One of the chief arguments advanced by the railroads that opposed Southern Pacific's application to acquire stock control of the debtor was that if the application were granted, Southern Pacific would be under an inducement to and would send over the debtor's rails large amounts of traffic which Southern Pacific controlled and which it was then sending over routes which it maintained jointly with debtor's many competitors, and that said competitors would no longer carry this traffic (R. 1081-1084). It was to be assumed, in view of Southern Pacific's heavy commitment in debtor, that it would use its utmost endeavors to obtain all possible traffic for the long haul over its system lines, including those of the debtor.

In November, 1932, the so-called Turney-Saunders agreement was signed, under the terms of which Southern Pacific and debtor agreed to actively and preferentially solicit all competitive traffic for the joint routes maintained by the two roads (R. 231-233, 2108). Southern Pacific, petitioner contends, while holding debtor to said agreement, itself utterly failed to carry out its part of the agreement, to debtor's great damage.

Upthegrove, President of debtor, in December 1935 testified that Southern Pacific did not solicit preferentially for debtor at the time (R. 3726-3727, 2987).

There is statistical evidence which conclusively proves this.

Debtor's freight revenues in 1931 were $16,385,466 (R. 1118). As appears from studies made by debtor's traffic department and obtained by petitioner in his examination of debtor's files in June 1939 in St. Louis, Southern Pacific as of 1931 was exchanging with competitors of debtor traffic which could have been sent over debtor and would have produced for debtor freight revenues in the amount of $14,035,807. A substantial amount of this traf-

fic, according to debtor's traffic department, Southern Pacific could have obtained at once for debtor. By 1935, the year when the petition for reorganization was filed, Southern Pacific had obtained for debtor, petitioner contends, only about $500,000 of this traffic (R. 2919-2932, 2951, 3482-3494, 2199, 5346-5348).[1]

There is also abundant documentary evidence in the record which shows that Southern Pacific did not solicit traffic preferentially for debtor as required by its agreement (*e. g.*, R. 3399-3415).[2]

Southern Pacific breached its fiduciary obligation to debtor as controlling stockholder by failing to carry out and at the same time holding debtor to the carrying out of the Turney-Saunders agreement. It also gravely breached its fiduciary obligation to the debtor in other ways to debtor's great damage (*e. g.*, R. 3423-3430).[2]

Moreover, in its relations with the debtor, in order to carry out its wrongful and illegal purposes, Southern Pacific unconscionably failed to take measures which would have increased the earnings of debtor (R. 3415-3420, 3430-3433, 3159-3163). Chief among these was a lease of the property of the debtor, which would have resulted in savings in operation to debtor of a million dollars per annum and in large increased earnings through additional traffic (R. 3163-3173, 3728-3732).[2]

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[1] Debtor in the year 1935, when the petition for reorganization was filed, failed to earn its interest charges of $3,150,307 by only $455,195 (R. 5329), or about 15% thereof. Petitioner showed that if Southern Pacific had influenced to debtor only some 3,000 cars of southbound traffic, or an average of about eight cars a day (which it readily could have done), debtor would have earned in net income an amount over and above its interest requirements for that year (R. 3161-3163). For the year 1936 debtor, despite increased expenses due to reorganization, failed to earn its interest charges by only $48,492, or about 1½% thereof (R. 5329).

[2] References are to the discussion in the brief submitted to the Commission (R. 3090-3471). There was a great deal of additional proof obtained in the hearings before Judge Davis (See R. 4051-5137).

Petitioner submitted to the Commission proof which showed that Southern Pacific's financial condition (R. 3148), and debtor's physical condition, both as to road and equipment (R. 3150-3154) and its progressive improvement in earnings (R. 3154-3157), warranted Southern Pacific in extending the small financial assistance that may have been deemed necessary to avoid reorganization. Indeed, such assistance could have been dispensed with as debtor's cash position on December 31, 1935, enabled it to meet its interest charges due January 1, 1936 (R. 3150).*

Petitioner also pointed out to the Commission the ulterior motives that prompted Southern Pacific in its control of debtor and in instigating the filing of the petition (R. 3146-3148, 3729-3731, 3137-3146, 3021-3038, 4832-4865).

In short, he showed that the proceedings were of a forced nature and that, considered from an honest business standpoint, they were neither in the interest of debtor nor of Southern Pacific Company.

Reports of the Commission

On June 30, 1941, the Commission issued its report with a plan of reorganization of debtor (*St. Louis Southwestern Ry. Co. Reorganization,* 249 I. C. C. 5, R. 3495-3735). After reviewing the proof placed in the record by petitioner in the hearings before it in support of his charges that debtor's assets had been wasted and its earnings impaired by railroads that had successively exercised control over the debtor in breach of the fiduciary and other obligations these railroads had been under to debtor and in violation of the antitrust laws, the Commission concluded

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* Six months previous to the filing of the petition, in connection with the approval of the extension of the loan by the Reconstruction Finance Corporation, the Commission found that debtor was not in need of reorganization (*St. Louis Southwestern Ry. Co. Reconstruction Loan,* 207 I. C. C. 377).

that such proof was not sufficient to sustain any of his charges (R. 3547-3678).

Chairman Eastman's dissenting opinion showed that he was convinced that petitioner had proved his charges to a very great extent (R. 3713-3732).

In its supplemental report dated March 9, 1942 (252 I. C. C. 325; R. 3736-3820), the Commission reaffirmed its original findings and conclusions.

Petitioner contends that the proof he introduced in the hearings before the Commission was more than sufficient to sustain his charges and to justify the granting of the relief requested. Assuming, however, as found by the Commission, that this was not so, petitioner submits that such proof was sufficient to require the Commission to undertake an investigation into the truth of his charges (R. 3844).

Yet, despite the fact that over one thousand security holders petitioned the Commission therefor (R. 3840), the Commission made no investigation (R. 3130-3136, 3714-3715).

Proceedings before the District Court

The petition for reorganization was filed by debtor in December, 1935, in the United States District Court for the Eastern Division of the Eastern Judicial District of Missouri. Your petitioner interposed an answer challenging its good faith (R. 83-87). Hearings were held before Judge Davis, who thereafter approved the petition, holding that the only matter for the Court's consideration was the financial condition of the company (R. 91-93, 433).

Prior to the commencement of the hearings in the District Court on the plan of reorganization, the United States, through the Department of Justice, moved to intervene in the proceedings for the purpose of objecting to the plan on the ground that its approval required a construction of the

antitrust laws which would seriously impede the enforcement of said laws in the transportation field (R. 4008-4033). The motion was denied (R. 4049).

In October and November, 1942, hearings upon the objections to the plan of reorganization were held before Judge Davis. In these hearings petitioner introduced additional proof in support of his charges, in the form of testimony of witnesses and documentary evidence. This proof, petitioner submits, is of a most important nature (See R. 4051-5137).

Thereafter, and before rendering a decision, Judge Davis died. The matter coming up before Judge Moore, petitioner moved for a new trial. This was denied (R. 5564-5569).

On February 9, 1944, the District Court rendered its decision approving the Commission's reports and plan of reorganization (*In re St. Louis Southwestern Ry. Co.*, 53 F. Supp. 914; R. 5183-5213). The Court held that the validity of petitioner's "charges of bad faith" was a matter "requiring study by experts on railroad affairs involving as they do * * * data peculiarly within the comprehension of the I. C. C." (R. 5203). It failed to review the evidence placed in the record by petitioner either in the hearings before the Commission or before the Court.

The trustee made investigations under subsection (c)(9) of Section 77 and rendered reports (R. 3903-3951). These investigations and reports, petitioner contends, were of a merely perfunctory nature.

Appeal to the Circuit Court of Appeals

From the decision of the District Court, this petitioner, debtor, Southern Pacific Company, and the Protective Committees for Holders of the First Mortgage Bonds of the Stephenville North and South Texas Railway Company and of the Central Arkansas and Eastern Railroad Com-

pany, appealed to the Circuit Court of Appeals for the Eighth Circuit.

The United States filed a brief *amicus curiae* in support of the position it had previously taken in its motion to intervene in the District Court (see R. 5640-5645).

The Circuit Court of Appeals affirmed the decision of the District Court (*St. Louis Southwestern Ry. Co.* v. *Henwood*, 157 F. (2d) 337; R. 5559-5683).

Referring to the question of whether the Rock Island, the Kansas City Southern, the syndicate and the Southern Pacific during their successive periods of control had harmed the debtor through diversions of traffic, the Court said (R. 5587-88):

> "* * * In determining this matter, we act under definite limitations. We cannot, as would a court in an equity suit, take the evidence before the Commission and declare an opposite conclusion if, in our judgment, the weight of the evidence was against the determination of the Commission. The Commission is the agency selected by the Congress to determine such fact matters. If there is substantial support in the evidence for its determination, we must accept it as settled (*Reconstruction Finance Corporation, et al.* v. *The Denver & Rio Grande Western R. Co.*, ... U. S. .... (June 10, 1946); *Ecker, et al.* v. *Western Pacific R. Co., et al.*, 318 U. S. 448, 473, 512).
>
> "Our examination involves, of course, a test comparison of the various essential fact statements of the Commission with the evidence bearing upon each material statement to ascertain whether there is substantial support for the finding in the evidence or the action of the Commission was arbitrary."

After quoting at length from the Commission's report (R. 5588-5626), the Court continued (R. 5627):

> "* * * In many instances, there was conflict in the evidence which the Commission might have ruled either way but such conflicts are for it, with its greater expert training and experience, to resolve and not for us."

Petitioner submits that the Circuit Court of Appeals, in view of the nature of the issues raised, was under a duty to make an independent review in order to determine whether the findings and conclusions of the Commission were against the weight of the evidence.

In an earlier part of its opinion, in discussing the subject of diversions of traffic, the Circuit Court said (R. 5580):

> "Unless one is an expert in railroad traffic matters or unless one has studied a record such as this it is highly difficult, if not impossible, to have much comprehension of the very great complexity of the subject."

It is petitioner's position that the more important items of proof in support of his contentions are of a comparatively simple and non-technical character.

Debtor's relations with Southern Pacific since April 1932 form the most important part of petitioner's proof because since that time debtor has formed part of the Southern Pacific system and to that company control of debtor will be restored after reorganization. The Court, however, to a large extent limited itself to its test comparisons to proof of the waste of assets and impairment of debtor's earnings during the years 1927 to 1932 previous to control by Southern Pacific (R. 5578-5640).*

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* The only item of proof referred to by the Court and not discussed by the Commission is the testimony of and graphs prepared by Millard, debtor's comptroller (R. 5627). Petitioner in his petition for rehearing showed that the Court misunderstood this proof (R. 5794-5801).

The relations between debtor and Southern Pacific after Southern Pacific took control, go almost without review by the Court.* The Court nowhere considers whether in accordance with the Turney-Saunders agreement Southern Pacific carried out its reciprocal obligation to solicit preferentially for the important joint traffic routes maintained by Southern Pacific and debtor or the breaches by Southern Pacific of its fiduciary obligation to debtor as controlling stockholder.

Motion to remand

On August 23, 1944, the United States instituted suit under the Sherman Antitrust Act against The Association of American Railroads, forty-seven Western railroads, Kuhn, Loeb & Company, another leading New York banking firm, and others, in the District Court of the United States for the District of Nebraska, Lincoln Division.

Thereafter, and on December 7, 1944, petitioner made a motion herein before the Circuit Court of Appeals for a stay, or in the alternative that the Court remand the proceedings to the District Court with instructions to remand to the Interstate Commerce Commission (R. 5287-5493).

The motion was made on two grounds, the first being the greatly improved financial condition of debtor. The second ground had a twofold aspect: (a) that the suit under the antitrust laws constituted a new development in the affairs of debtor which, in the event of its successful termination, would result in greatly increased earnings for debtor; and (b) that the facts revealed by the allegations of the complaint in said suit, and the "Western Agreement" annexed as an exhibit to said complaint,

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* The Court reviews the proof as to Southern Pacific's failure to lease debtor (R. 5645-5652). Its holding as to this was against the weight of the evidence (R. 3163-3173); Chairman Eastman's dissenting opinion (R. 3728-3731).

constituted newly discovered evidence relevant and important to the issues herein (R. 5289).

As to the second ground, the Court overlooked the fact, as alleged by petitioner, that a successful conclusion of the Government's suit would result in greatly increased earnings for the debtor. The Circuit Court denied petitioner's motion because, as it held, he had previous knowledge of the Western Agreement (R. 5571-5573). Petitioner submits that assuming he had that knowledge, which he denies, the many thousands of security holders should not be made to suffer on that account.

Changed conditions

The plan of reorganization of the Commission was to be effective as of January 1, 1942.

The Commission placed a valuation on the property of $68,523,903 as of December 31, 1935 (R. 3501-02).

Interest charges under the plan are cut from $3,023,893 as of 1941 to $1,513,723 (R. 3782). Bondholders and other creditors remain unprovided for to the extent of $8,243,764 (R. 3782). The preferred and common stock are wiped out (R. 3700, 3784).

Since January 1, 1942, there have been reductions in principal and accrued interest on debtor's indebtedness in an amount greater than the amount unprovided under the plan for bondholders and other creditors.

Net current assets as of January 1, 1942, were $2,352,344 (R. 5259, 5261). Net current assets as of October 31, 1946, were $22,090,504, an increase of $19,738,160 (Dist. Ct. Pr. R.* 10578-9).

From January 1, 1942, to November 30, 1946, debtor earned a total net income (over and above all interest

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* District Court Printed Record.

charges) amounting to $29,373,376 (R. 5257, 5741; figures for 1946 from Moody's Railroads).

After January 1, 1942, the effective date of the plan, debtor's earnings were greater than previous to that date. Debtor earned in net income in 1941, $4,472,048; 1942, $5,673,577; 1943, $7,543,273; and 1944, $8,119,085 (R. 5257). For the first nine months of 1945 net income amounted to $6,507,850. Because of the accelerated amortization of defense projects during the last three months, debtor showed net income for the year of $3,993,006. For the first eleven months of 1946, debtor earned in net income $4,044,035.

Jurisdiction

The judgment of the United States Circuit Court of Appeals was entered on August 26, 1946 (R. 5681-5683). The petition for rehearing was filed on September 25, 1946 (R. 5829), and denied on October 22, 1946 (R. 5831).

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code [28 U. S. C. A. 347 (a)] as amended.

Questions Presented

1. Where a judge who presided at the hearings upon the objections to a plan of reorganization formulated by the Interstate Commerce Commission in a Section 77 proceeding, died without rendering a decision, was it within the power of a successor judge to refuse to grant new hearings and thereafter to render his decision upon a record made before the deceased judge?

2. Where minority stockholders in a Section 77 proceeding introduced proof in the hearings before the Interstate Commerce Commission and the District Court in support of their contentions:

(a) that the earnings of the debtor taken by the Commission on which it based its estimate of debtor's prospective earnings for capitalization purposes under the plan, had been impaired by those who had controlled debtor in breach of fiduciary, contractual and other obligations and in violation of the antitrust laws, and that if the Commission had made due allowance for such impairment a plan of reorganization would have been required which would have provided for the minority stockholders; and

(b) that the claim of a large creditor and stockholder of debtor, because of its wrongful, illegal and unconscionable acts in its relations with the debtor, should be expunged or at least subordinated to the interest of other creditors and security holders, and that, as a result of such expunging or subordination, minority stockholders would be provided for under the plan;

and where the Commission held that such proof was not sufficient to sustain such contentions; and where under the plan formulated by the Commission the equity of the minority stockholders was entirely wiped out, should the District Court and should the Circuit Court of Appeals have made an independent review of the said proof and of the findings and conclusions of the Commission in connection therewith?

3. Where under a plan of reorganization in a Section 77 proceeding debtor railroad was to be restored to the control of another railroad, which latter railroad in its previous exercise of control, it was charged, had breached its fiduciary, contractual and other obligations to debtor, and where the Circuit Court of Appeals held that there was a conflict in the evidence as to which the Commission might have ruled either way, should the Commission and the District Court have made a thorough investigation of

the character of the control previously exercised in order to insure a control upon emergence from reorganization which would be in the interest of the debtor and all of its security holders?

4. Where in an appeal to the Circuit Court of Appeals in a Section 77 proceeding a motion was made to remand to the District Court with instructions to remand to the Interstate Commerce Commission on the grounds, among others, that a certain suit under the antitrust laws brought by the Government constituted a new development in the affairs of the debtor which, in the event of a successful conclusion, would result in a great increase in debtor's earnings, and also that the facts revealed by the allegations of the complaint in the said suit and by an agreement annexed as an exhibit thereto constituted newly discovered evidence, should the Court have denied the motion on the ground that the moving party had such knowledge of the facts that he was precluded from claiming that they constituted newly discovered evidence?

5. In view of the great improvement in net assets, reduction in principal indebtedness and accrued interest, improvement in net current assets and in earnings since the supplemental report of the Commission, is a new plan of reorganization necessary?

Statute Involved

The statute involved is Section 77 of the Bankruptcy Act (11 U. S. C. A. 205), and particularly subsections (b), (c)(9), (d), and (e) thereof. Certain pertinent language of said subsections is printed in the Appendix at pages 61-64 hereof.

Reasons Relied Upon for Allowance of Writ

1. The judge who presided at the hearings upon the objections to the plan of reorganization for debtor, died without rendering a decision. The Circuit Court of Appeals, in holding that it was within the discretion of the successor judge to refuse a new trial upon the issues raised, so far sanctioned a departure by the lower court from the accepted and usual course of judicial proceedings as to call for an exercise of the Supreme Court's power of supervision, and also decided an important question of Federal law which has not been but should be determined by this Court.

2. The Commission took the record of earnings of debtor from 1927 to 1941 on which to base its estimate of prospective earnings for the purpose of determining the capitalization in the plan of reorganization of debtor. Under the plan the interest of the minority stockholders is entirely wiped out.

Petitioner introduced proof in the hearings both before the Commission and the District Court, that during the said period the earnings of debtor had been impaired through the illegal control exercised over debtor by successive railroads in breach of the fiduciary obligation these railroads were in to debtor as controlling stockholders, and in violation of the antitrust laws, and contended that but for the said impairment, the earnings would have been greatly in excess of the recorded earnings and that the Commission should have made due allowance therefor.

The Commission found that the proof did not sustain petitioner's contentions.

The District Court failed to review the proof introduced as to such illegal impairment.

The Circuit Court of Appeals, in approving the plan of reorganization without an independent review of and affirmation as to the aforesaid proof, decided a question

of Federal law probably in conflict with the decisions of this Court in *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448, 478, 479, 514; *Group of Investors* v. *Milwaukee R. Co.*, 318 U. S. 523, 536; and *Reconstruction Finance Corp.* v. *Denver & Rio Grande Western R. Co.*, ... U. S. ..... (June 10, 1946), Adv. Sheets 90 L. ed. 1134, 1141.*

3. The Circuit Court of Appeals, in approving a plan of reorganization which deprives minority stockholders of debtor of their entire equity in the property, without an independent review of the proof in the record on the issue raised by petitioner that Southern Pacific's claim as a creditor and as a stockholder should be expunged or at least subordinated to the interest of other creditors and security holders of debtor, decided an important question of Federal law probably in conflict with the decisions of this Court in the *Western Pacific* (p. 479), the *Milwaukee* (p. 536) and *Denver & Rio Grande* (p. 1139) cases, *supra*.

4. The Circuit Court of Appeals, in failing to hold that the claim of Southern Pacific should be expunged or at least subordinated because Southern Pacific, in preventing debtor from asserting a valuable cause of action under the antitrust laws against Kansas City Southern and others, had breached its fiduciary obligation to debtor, decided a question of Federal law in such a way as to impede the enforcement by the United States of the antitrust laws in the transportation field and in a way probably in conflict with applicable decisions of this Court.

5. The Circuit Court of Appeals, in failing to remand to the District Court with appropriate instructions to remand to the Commission on the ground that the Commission had made no investigation and the trustee, as shown by his reports, had made only a perfunctory investigation

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* These decisions are hereinafter sometimes referred to as the *Western Pacific*, the *Milwaukee*, and the *Denver & Rio Grande* cases.

of the control exercised over debtor by predecessors of Southern Pacific and by Southern Pacific, to which latter company control over the debtor will be restored after emergence from reorganization, decided an important question of Federal law contrary to the intent of Congress in enacting Section 77 as recognized by this Court in *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448, 471, and one which has not been but should be determined by this Court.

6. The Circuit Court of Appeals, in denying petitioner's motion to remand the proceedings to the District Court on the ground that petitioner had knowledge of the "Western Agreement" annexed as an exhibit to the complaint in the suit under the anti-trust laws by the United States against The Association of American Railroads and others, decided an important question of Federal law probably in conflict with the decisions of this Court in *Consolidated Rock Products Co.* v. *DuBois,* 312 U. S. 510, 520, 526; *National Surety Co.* v. *Coriell,* 289 U. S. 426, 436; and *First National Bank* v. *Flershem,* 290 U. S. 504, 525, which hold that in receivership or reorganization proceedings the court stands in a position different from that which it occupies in ordinary litigation in that every important determination in such proceedings calls for an informed independent judgment.

7. The Circuit Court of Appeals, in holding that a new plan of reorganization of debtor was not required despite changed conditions since the formulation of the plan, including a great improvement in assets, decrease in principal indebtedness and accrued interest, increase in net current assets, continuous and progressive improvement of earnings during the war, and large earnings during the post-war period, decided an important question of Federal law which has not been but should be determined by this Court. The facts as to the foregoing changed conditions serve to distinguish debtor's case from the *Denver & Rio Grande* case.

8. The Circuit Court of Appeals, in holding, in connection with its approval of the elimination of stockholders under the plan, that the amount owed by debtor to secured creditors was not to be measured by the amount of their respective claims with accrued interest but by the par value of the securities with accrued interest held as collateral by said creditors, which was much in excess of the amount due on the claims, and that this, together with the indebtedness unprovided for, was to be considered in determining that the plan formulated by the Commission was not arbitrary, decided an important question of Federal law in conflict with the decisions of the Circuit Court of Appeals for the Second Circuit in *In re New York, N. H. & H. R. Co.*, 147 F. (2d) 40, 47, and of the Circuit Court of Appeals for the Seventh Circuit in *In re Chicago & N. W. Ry. Co.*, 126 F. (2d) 351, 369, and one which, irrespective of the said conflict, has not been but should be settled by this Court.

WHEREFORE, your petitioner prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Eighth Circuit, commanding said Court to certify and send to this Court on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 12,886, In Bankruptcy, Walter E. Meyer, Intervener, Appellant, v. Berryman Henwood, as Trustee of St. Louis Southwestern Railway Company Lines, *et al.*, appellees, to the end that this cause may be reviewed and determined by this Honorable Court, and that the judgment of the said Circuit Court of Appeals be reversed; and that your petitioner have such other and further relief as may seem proper.

Dated, New York, January 17, 1947.

WALTER E. MEYER,
Petitioner, *Pro Se*,
And as Attorney for other Stockholders.

R. WALSTON CHUBB,
Attorney for Petitioner.

In the

Supreme Court of the United States

October Term, 1946

No.

Walter E. Meyer, Intervener,

Petitioner,

v.

Berryman Henwood, as Trustee of St. Louis Southwestern Railway Company Lines, *et al.*,

Respondents.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Opinions Below

The initial report of the Interstate Commerce Commission (R. 3495-3735) is reported in 249 I. C. C. 5; its supplemental report and order (R. 3736-3820) in 252 I. C. C. 325.

The opinion of the District Court (R. 5183-5213) is reported in 53 F. Supp. 914.

The opinion of the Circuit Court of Appeals (R. 5559-5680) is reported in 157 F. (2d) 337.

Statement

The statement of the case set forth in the petition under the heading "Statement of Matter Involved" is hereby adopted and made part of this brief.

Specification of Errors

The Circuit Court of Appeals erred:

1. In affirming the order of the District Court approving the plan of reorganization of the debtor in all respects with one exception, to wit, the provisions in said plan with respect to the Stephenville North & South Texas and the Central Arkansas & Eastern bondholders.

2. In holding that it was within the discretion of Judge Moore to deny petitioner's motion for new hearings, Judge Davis, who had presided at the hearings upon petitioner's objections to the plan of reorganization, having died without rendering a decision.

3. In failing to make an independent review of the proof in the record in the hearings before the Interstate Commerce Commission and in the District Court in support of petitioner's charges of misfeasance by those successively in control of debtor, in order to determine whether the findings and conclusions of the Commission were against the weight of the evidence.

4. In failing to remand the proceedings to the District Court with instructions to remand to the Commission with appropriate instructions to prepare a new plan providing in full for all security holders and creditors of debtor but expunging or at least subordinating the claim of Southern Pacific Company on the ground that there was overwhelming proof which required such a plan.

5. In failing to remand the proceedings to the District Court with instructions to remand to the Commission on the ground that neither the District Court nor the Commission had made the thorough investigation of the previous relations of Southern Pacific Company with debtor necessary to assure sound and reliable control of debtor by Southern Pacific upon emergence from the bankruptcy court.

6. In holding that a new plan of reorganization was not required, despite the showing made by debtor in earnings since the Commission's supplemental report in March 1942, both during the war period and since the termination of the war, and despite the increase in assets, reduction in indebtedness and increase in net current assets.

7. In holding, in determining the net assets and the financial condition of debtor in order to decide whether a new plan was required, that the amount owed by debtor to Southern Pacific Company, Chase National Bank and Mississippi Valley Trust Company was to be measured, not by the face amount of the said claims with accrued interest, but by the face amount with accrued interest of the bonds of the debtor held as collateral respectively by these creditors.

8. In denying petitioner's motion made before the Circuit Court of Appeals for a remand of the proceedings to the District Court with instructions to remand to the Commission with appropriate instructions, the motion having been based on the ground that the Government's suit against The Association of American Railroads and others constituted an important development in the affairs of the debtor which in the event of a successful outcome would add greatly to debtor's earnings, and that the allegations of the complaint in the said suit and the Western Agreement annexed as an exhibit to the complaint constituted newly discovered evidence relevant and important to the issues in the case.

ARGUMENT

POINT I

The Courts failed to make an independent review in order to determine whether there was legal objection to the record of earnings taken by the Commission in estimating debtor's prospective earnings, and whether the claim of Southern Pacific Company should be expunged or at least subordinated to the interest of other creditors and security holders.

Petitioner's objections to the plan and his claims for equitable treatment include among others:

(1) That the plan failed to make any provision for stockholders and made inadequate provision for bondholders because the Commission failed to give proper weight and effect to the proof in the record that the earnings of debtor from 1927 to 1941, on which the Commission based its estimate of prospective earnings, did not represent debtor's real earning power and that the earnings for said period had been impaired through the illegal control exercised over debtor; and

(2) That the plan failed to expunge or at least subordinate the interest of Southern Pacific to the interest of other security holders and creditors. This should have been done because Southern Pacific had violated its contractual, fiduciary and other obligations to debtor, as a result of which debtor had been greatly damaged. If Southern Pacific's claim had been expunged or subordinated this would have resulted in a plan which would have taken care in full of the claims of all other creditors and security holders. (R. 3840-3848.)

The issues upon which this Court is asked to rule involve, broadly speaking, a determination as to whether

if the debtor, as petitioner contends, has been the victim of wrongdoers, these wrongdoers are to be allowed in a railroad reorganization proceeding to carry out unconscionable and unlawful purposes repeatedly condemned by this Court when resorted to in corporate reorganizations under Section 77B and in other proceedings (*Louisville Trust Co.* v. *Louisville, N. A. & C. R. Co.*, 174 U. S. 674; *Southern Pacific Co.* v. *Bogert*, 250 U. S. 483; *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307, and *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510).

The facts concerning which there is controversy in these proceedings and the questions of law involved differ from those in other reorganizations that have come before this Court. In the interpretation of Section 77 herein, an opportunity is presented for further clarification by this Court as to the respective functions of the Commission and the court.

The Supreme Court in the *Western Pacific* case, in reviewing the legislative history of Section 77, states that after the bill passed the House with power lodged in the Commission, the Senate adopted changes designed to give more power to the court (p. 470). Even in the House, however, Mr. LaGuardia, chief sponsor of the bill, stated in respect to the proposed legislation that it was not intended that mistakes of law should not be rectified (72d Cong., 2d Sess., 76 Cong. Rec. 2924). Later, in connection with the amendment of the bill in 1935, it was stated that an outstanding beneficial feature of the legislation was the double check involved in the necessity of the approval of the plan by both the Interstate Commerce Commission and the courts (74th Cong., 1st Sess., 79 Cong. Rec. 13301, 13767).

The *Western Pacific* case discusses at length the respective functions of the Commission and of the court in Section 77 proceedings.

As appears from that case:

While "valuation is a function limited to the Commission" (p. 472), and it is only incumbent on the court to determine whether there is material evidence to support the Commission's appraisal (p. 473), even in such case the court is under a duty to determine whether the valuation by the Commission is in accordance with statutory standards and whether there is any valid legal objection to such appraisal (pp. 477-479).

In the discharge of its duties in "a simple case" involving no questions of law (p. 479) and where there is material evidence to support the conclusion of the Commission (p. 473), the court by a "mere mathematical computation" is able to determine whether claimants are without equity (p. 479).

Where, however, a plan allows nothing to stockholders, or to stockholders and creditors, in view of the fact that the plan is not submitted to those whose interest is thus entirely eliminated, and in view of the specificity of the direction in the statute for re-examination of the Commission's action in such case "a wider scope of review" is necessary than would otherwise be the case though not to the extent of an independent appraisal of the valuation (pp. 478-479).

It would thus appear that where stockholders, or stockholders and certain of the creditors, are being deprived of their entire interest, even on a simple state of facts involving no questions of the priority or validity of claims, or of conflicting liens, a wider scope of review than would otherwise be the case is required.

In these proceedings not only are stockholders under the plan deprived of their entire interest. There are many questions of law present arising out of petitioner's contentions as to illegal impairment of earnings and as to the priority and validity of Southern Pacific's claim.

In such case, as stated by this Court, "the court properly affirms the Commission" only "when it finds no legal objection to the Commission's use of its own valuation to determine whether particular claimants are entitled to participate in the reorganization. For example, there may arise controversies over the priority or the validity of claims. A Commission finding involving such problems would require an independent examination and affirmation by the court" (pp. 478-479).

The construction of the statute in the *Western Pacific* case as to the respective functions of Commission and court was expressly reaffirmed in the *Milwaukee* case (318 U. S. 523, 536), and in the *Denver & Rio Grande* case (Adv. Sheets 90 L. ed. 1134, 1139). In its careful reviews in these cases where questions of law were involved, the Supreme Court put into practice the principle it laid down.

Such a construction is justified by sound and practical reasons.

The Supreme Court in the *Western Pacific* case refers to the intent of Congress to utilize "the Commission's experience for the appraisals of values" (p. 468) and to the familiarity of the Commission with railroad securities because control over their issuance by interstate carriers had been for many years in the Commission (p. 481).

The Commission has had much experience in matters of physical valuation under Section 19a of the Interstate Commerce Act (49 U. S. C. A. 19a), and also in connection with its supervision of the issuance of securities under Section 20a of that Act (49 U. S. C. A. 20a).

It has had little or no experience in passing upon issues of the character presented by petitioner's charges.

The district courts of the United States, however, have had wide experience in questions of law and of fact in-

volving breaches of fiduciary obligations by majority stockholders, violation of the antitrust laws, breaches of contract, and unconscionable conduct of such a character that while its victims may obtain no relief in law courts, courts of equity are wont to give them relief in accordance with the doctrine laid down by this Court in *Pepper* v. *Litton*, 308 U. S. 295.

In the *Western Pacific* case (p. 471) this Court held that under subsection (e) of Section 77 "the District Court has definite responsibility in reorganization."

Among its duties is the duty of holding hearings upon objections and thereafter of approving or disapproving the plan of the Commission. "If the judge shall not approve the plan, he shall file an opinion stating his conclusions and the reasons therefor * * *" (Subsection (e)).

Another responsibility is to require the trustee, in accordance with the provisions of subsection (c)(9) to report to the court "any facts pertaining to irregularities, fraud, misconduct, or mismanagement, as a consequence of which the debtor may have a cause of action arising therefrom against any person or corporation."

In the effective discharge of its responsibility to review under the statute the district court is in a specially advantageous position.

As the court of original jurisdiction the district court hears all motions by parties in interest. Through the numerous applications which the trustee makes for authorization to act, the court acquires a knowledge of the affairs of the debtor. The responsibility imposed under the statute of holding hearings upon objections and requiring the trustee to report, carries with it opportunities to get at the facts with respect to any fraud, misconduct and mismanagement.

In its opinion the District Court below, through Judge Moore, held (R. 5203):

"* * * a determination of the validity of Meyer's charges of bad faith are matters requiring study by experts on railroad affairs, involving, as they do, expert analysis of traffic movements, freight loadings, financial statements, and other data peculiarly within the comprehension of the I. C. C. We are of the opinion that the Commission has had full opportunity to pass on these matters and exercise informed judgment. We are, therefore, not disposed to refer the plan back to the Commission on this account and, accordingly, overrule Meyer's objections to the plan of reorganization."

The District Court set forth certain of petitioner's charges and certain items of proof introduced by him in support thereof (R. 5197-5198).

It formally found that the valuation and capitalization under the plan of reorganization were "in accordance with proper legal standards" and "that the legal conclusions stated by the Commission" in its reports "are in accordance with the law of the land" (R. 5212).

As indicated by the language first quoted, and as appears from its entire opinion, the District Court, however with one exception, made no attempt to pass upon the findings of fact and conclusions of the Commission bearing on petitioner's charges.*

* The sole exception was the comment on the Turney-Saunders agreement, under which the debtor and Southern Pacific agreed to actively and preferentially solicit traffic for the Cotton Belt-Southern Pacific joint traffic routes. The Court refers to the proviso in that agreement that "routings would be such as to permit maximum revenue to the Southern Pacific system and that the Southern Pacific maintain fair interchange of traffic with other lines" (R. 5198). Paragraph 2 of the agreement states: "Southern Pacific will actively and preferentially solicit all competitive traffic which can be handled by the Cotton Belt in connection with that Line, provided that the Maximum gross revenue is thereby yielded to the System, including within the term 'System,' the Cotton Belt Lines * * *" (R. 231). The above language of the Court fails to bring out that in the determination of what was the maximum revenue to the Southern Pacific the debtor (Cotton Belt) was to be included.

The proof introduced by petitioner in the District Court before Judge Davis, who had presided at the hearings, also went without review by Judge Moore. The testimony and exhibits in these hearings cover over one thousand pages of the printed record (R. 4051-5137). Of these pages at least two-thirds, petitioner estimates, are taken by petitioner's proof. This proof is of a most important character despite the fact that petitioner was limited by Judge Davis to the period after the conclusion of the hearings before the Commission in September 1939 (R. 4186). It includes (a) new important proof, and (b) cumulative proof of matters in the record in the hearings before the Commission in support of petitioner's charges. This proof has had the benefit of review neither by the Commission nor by the District Court, nor, as will be shown, by the Circuit Court of Appeals.

The District Court failed to make that minimum review of the findings and conclusions of the Commission required even in a "simple case" of valuation in order to determine whether there was material evidence to support the conclusions of the Commission. In the instant case, where stockholders are being deprived of their entire equity, and where many questions of law and mixed questions of law and of fact have been raised, the error of the District Court in failing to make an independent review resulted in depriving the stockholders of an important safeguard provided under the statute.

Nor was the failure by the District Court to review remedied by the inadequate review by the Circuit Court of Appeals. The special facilities afforded the District Court in getting at the truth in the discharge of its responsibilities of review have been referred to.

These facilities are not available to an appellate tribunal.

The Circuit Court of Appeals erred not only in failing to review as to the weight of the evidence and in limiting

its review to whether there was substantial support in the evidence for the determination of the Commission. It also erred in reviewing only by test comparisons.

Whatever the propriety of test comparisons in certain cases, petitioner submits that their use was not proper in the instant case.

Of the methods to be pursued in the analysis of evidence, Professor Wigmore states:

> "The object, of course, is to determine rationally the *net persuasive effect of a mixed mass of evidence.* Many data, perhaps multifarious, are thrust upon us as tending to produce belief or disbelief. Each of them (by hypothesis) has some probative bearing. Consequently, we should not permit ourselves to reach a conclusion without considering all of them and the relative value of each. Negatively, therefore, our object is (in part) to avoid being misled (it may be) through noticing only some fragment in the mass of data while ignoring some other fragment, or through overvaluing or undervaluing any fragment. We must assume that a conclusion reached upon fragments only will be more or less untrustworthy * * * (John H. Wigmore, *The Science of Judicial Proof,* pp. 46-47).

The test comparisons were as to proof of waste of assets and impairment of earnings of debtor during the years 1927 to 1932.

The most important part of petitioner's case,—the relations of debtor with Southern Pacific Company after 1932 when debtor became part of the great Southern Pacific System, and the abundant proof in the record bearing on such relations,—remained to a very great extent without review by the Court.

In its test comparisons as to whether there was substantial support in the evidence for the determination of the

Commission, the Circuit Court of Appeals either misunderstood the purpose or the nature of the proof. In some instances the Court did both (Petition for rehearing, R. 5791-5812).

In its review the Circuit Court of Appeals found that: "In many instances, there was conflict in the evidence which the Commission might have ruled either way * * *" (R. 5627).

In reviewing to determine only whether there was substantial proof to support the findings and conclusions of the Commission on questions of law and mixed questions of law and fact, and this by test comparisons, the Circuit Court erred. This has resulted in a grave injustice to the minority stockholders and to other security holders of debtor.

Petitioner under this point heading has referred to two issues raised by his objections,—the issue as to whether debtor's earnings were illegally impaired and the issue as to whether the claim of Southern Pacific should be expunged or at least subordinated. Any differentiation in these proceedings as to the extent and scope of the review required by the courts as between the two issues would be purely academic, as all of the proof relevant to the issue as to whether debtor's earnings were illegally impaired is also relevant to the issue as to whether Southern Pacific's claim should be subordinated or expunged.

The Commission recognized that this was so when, referring to petitioner's brief (R. 3176, *et seq.*), it stated:

> "Meyer argues, and correctly so, that facts concerning the alleged breaches of fiduciary relationship to the debtor, and violations of the antitrust laws, are relevant in support of an effort to prove that the record of earnings of the debtor for the years 1927 to 1936 was not indicative of its real earning power on the basis of which a plan of reorganization may be

formulated, and to prove that the debtor has causes of action against those who, as alleged, conspired in the wrongdoing" (R. 3567).

Southern Pacific's claim is in the principal amount of $17,882,250 with accrued interest. Proof bearing on the issue as to its priority and validity includes wrongful and illegal acts by Southern Pacific both previous to and after taking formal control of debtor with the authorization of the Commission in April, 1932.

The Circuit Court of Appeals, however, limits its discussion of this aspect of petitioner's proof to the brief filed by the United States through the Antitrust Division of the Department of Justice (R. 5640-5645).

The Government contended that Southern Pacific's failure to permit the debtor to assert causes of action *under the antitrust laws* against Kansas City Southern and others arising out of impairment of earnings by reason of control over debtor by Kansas City Southern, "was a breach of trust which Southern Pacific is bound to account for" and which called for the subordination of Southern Pacific's claim in the plan of reorganization (R. 5641).*

The Court asked why the Government did not prosecute the Kansas City Southern if it deemed that that railroad had violated the Antitrust Act (R. 5644). It is the duty

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* The Court makes the comment that: "In some respects, this last hour appearance of the Government is extraordinary" (R. 5644). The Court is under a misapprehension. The Government's brief was filed with the Circuit Court of Appeals in February, 1945. Over two years before that time, however, in September, 1942, in the hearings before Judge Davis upon the objections to the plan of reorganization, the Government filed a motion to intervene and brief in support in which the Government contended that Southern Pacific should be subordinated. These form part of the printed record (R. 4007-4033). The motion was denied (R. 4049-4050).

of the Interstate Commerce Commission, not of the Attorney General, to institute proceedings against railroads for violations of Section 7 of the Clayton Antitrust Act. The Commission instituted and afterwards discontinued such proceedings by a vote of six to five (*Interstate Commerce Commission* v. *Kansas City Southern,* 156 I. C. C. 359; R. 5446-5452).

As to the holding by the Court that if it should be made to appear that a cause of action existed, the proper procedure would be to have such action placed in a trustee with proper provisions as to the disposition of any recovery (R. 5645).

The *amicus curiae* brief filed by the Government, quoted at length by the Court, shows that while debtor could have asserted causes of action up to April 15, 1934, "the inaction" of Southern Pacific for a period of four years had "permitted those primarily liable to escape liability through the running of the statute of limitations" (R. 5644).

The Circuit Court of Appeals was also of the opinion that because of the uncertainty in the amount of any recovery if suit were brought against Southern Pacific, for that reason, among others, the claim against Southern Pacific should not be subordinated.

The fact that there is uncertainty as to the amount of ultimate recovery does not preclude subordination. *Taylor* v. *Standard Gas & Electric Co.,* 306 U. S. 307, 323-324; *Columbia Gas & Electric Corp.* v. *United States,* 6 Cir., 153 F. (2d) 101, 102; *In re Commonwealth Light & Power Co.,* 7 Cir., 141 F. (2d) 734, 739.

POINT II

Both the Commission and the District Court failed to make the thorough investigation necessary to assure control of debtor in the interest of debtor and of all of its security holders upon emergence from reorganization proceedings.

The Congressional debates prior to the enactment of Section 77 show that one of the chief purposes of the bill was to take railroad reorganizations out of the hands of the group of men who had made it a practice to wreck railroads (72nd Cong. 2d Sess., 76 Cong. Rec. 4887, 5358).

The Supreme Court in the *Western Pacific* case (at p. 471), in discussing the legislative history of Section 77, quoted from the Senate Report upon the amendment enacted in 1935 as follows:

> "The Senate Report, No. 1336, 74th Cong., 1st Sess., concluded:
>
> 'The amendments to Section 77 leave unimpaired the power and the duty of the commission and the courts to deal with the most important feature of all reorganization plans, that of the control of the reorganized company; and similarly the commission and courts will continue to have the power and authority of making that thorough investigation which is necessary to assure sound and reliable control for bankrupt companies when they emerge from the courts, in place of the type of control under which some railroads have been wrecked'."

Under Section 12 of the Interstate Commerce Act (49 U. S. C. A. 12) the Interstate Commerce Commission is given broad investigatory power (*Smith* v. *Interstate Commerce Commission*, 245 U. S. 33). In numerous instances the Commission has used this power to expose abuses in the control and operation of railroads (*Consolidations and*

Combinations of Carriers, 12 I. C. C. 277; *St. Louis and San Francisco Railroad Investigation,* 29 I. C. C. 139; *Financial Investigation of New York, New Haven & Hartford R. R. Co.,* 31 I. C. C. 32; *Pere Marquette R. R. Co. & C., H. & D. Ry. Co.,* 44 I. C. C. 1; *Denver & Rio Grande Investigation,* 113 I. C. C. 75; *Chicago, Milwaukee & St. Paul Investigation,* 131 I. C. C. 615; *New York, N. H. & H. R. Co. Investigation,* 220 I. C. C. 505).

Petitioner submits that the facts in the record constitute overwhelming proof of his charges. Assuming, however, that these facts were not sufficient to convince the Commission as to the truth of these charges, certainly they were sufficient to require the Commission to institute an investigation. Yet no investigation was ever made by the Commission in these reorganization proceedings.

Within a few days after the initiation of the reorganization proceedings on December 12, 1935, petitioner asked, at an informal hearing granted by Division 4, that the Commission investigate the effect of the control by Southern Pacific and predecessors of Southern Pacific upon the traffic and earnings of the debtor, and presented facts to that end. The Chairman of the Division stated that an investigation was not warranted at the time but that an opportunity would be "presented in connection with consideration of a plan of reorganization" of debtor "to investigate all phases of its traffic problems and relations with other carriers" (R. 451).

At the hearings in connection with the formulation of a plan in 1937, the Commission introduced no proof whatsoever on the subject of debtor's traffic relations with other railroads. Petitioner took the stand and endeavored to introduce such proof. He was not permitted to do so (R. 458-462).

On or about April 12, 1937, petitioner filed with the Commission a petition for investigation (R. 339-351). He

asked that the hearings remain open pending a decision upon his petition (R. 359). The hearings were closed. On June 21, 1937, he filed an amended and supplemental petition (R. 357-467) requesting that the Commission investigate. Thereafter the petitions were denied (R. 479-480).

Other security holders joined in the petition for investigation at the time or later, in all amounting to 1188 bondholders owning $4,200,000 par value of bonds and 148 stockholders owning, together with petitioner's, stock of a par value of $4,230,900 (R. 3840).

By order of January 10, 1939, the Commission finally reopened the proceedings. The reopened proceedings, however, were in no sense an investigation. The Commission called no witnesses, nor did it place any documentary evidence in the record with the exception of a report of the Bureau of Inquiry on data hitherto not made public. This data was obtained as a result of an investigation conducted during the years 1927-1929 of the traffic relations respectively of the debtor, of Kansas City Southern and of Missouri-Kansas-Texas with other railroads for the period 1924 to 1927 only (R. 3600-3604, 1727-1787; 5777-5783).

Southern Pacific refused to produce documentary evidence called for by petitioner, stating that the reopened proceeding was an adversary proceeding (R. 1574, 1588).

That the reopened proceedings were not an adequate substitute for an investigation is evident from the fact that petitioner was given but a very limited opportunity to obtain additional proof in support of his charges. A motion made by him for a postponement of four months in order that he might take the depositions of witnesses residing at distant points was denied (R. 522, 528-529).

Petitioner expressed the opinion that the relation of Southern Pacific with debtor was the "jugular vein" of the case (R. 1590). He filed a petition for a subpoena

duces tecum to be directed to Southern Pacific (See R. 3470-3471). This, except in very small part, was denied (R. 1633-1634, 1646, 1648-1649, 1655 *et seq.*).

His request that the Commission require Southern Pacific to compile data of its traffic relations with competitors of debtor, even after the request was modified so as to include only one day of every month for the year 1935 *or* 1938, was denied (R. 513-522, 508, 528-529).

The Commission states (R. 3674):

> "As for the production of correspondence files of the Southern Pacific, those files are also large, and, moreover, that carrier has a property right in its files, and is entitled to keep its own counsel until there is some reasonable showing that the public interest or the ends of justice require a disclosure."

Only after the adjournment of the May 1939 hearings, and after almost all of the witnesses called by debtor and by Southern Pacific had testified, was petitioner in June, 1939, given access to a limited number of the debtor's files in St. Louis. A selection from the important documentary evidence obtained by petitioner in his examination and submitted at the September 1939 hearings, appears in the printed record (R. 2735-2976).

The Commission in its report refers a number of times to "investigations", viz., "Investigations on our own motion" (R. 3600); the "exhaustive investigation which has been made" (R. 3674); and "We are of the opinion that the investigations already made are sufficient, * * *" (R. 3676).

The "Investigations on our own motion" refer to the investigation by the Bureau of Inquiry made during the years 1927-1929 of traffic relations for the years 1924-1927, previously referred to.

Chairman Eastman in his dissenting opinion dwells at length on the fact that the Commission made no investigation (R. 3714-3715).

As to the reports of the trustee:

The trustee of the debtor was ordered by the District Court under date of February 24, 1936, "in accordance with the mandatory provisions of paragraph (c)(9) of amendatory Section 77 of the Acts of Congress relating to bankruptcy" "to report to the Court any facts pertaining to irregularities, fraud, misconduct or mismanagement, as consequence of which the Debtors, or any of them, may have a cause of action arising therefrom against any person or corporation" (R. 3903).

The trustee issued seven reports in which the matters which he was ordered to investigate are referred to. These reports are dated as follows: February 23, 1937 (R. 3903-8); February 25, 1938 (R. 3909-21); February 28, 1939 (R. 3921-33); April 5, 1940 (R. 3933-42); March 21, 1941 (R. 3942-47); April 22, 1942 (R. 3948-50); May 7, 1943 (R. 3950-51).

Preparatory to his first report of February 23, 1937, the trustee wrote to the officials of debtor and asked them to make affidavit to the fact that they knew of no frauds or irregularities (R. 3904). It was hardly likely that officials, if they were desirous of retaining their positions, would come forward with information as to frauds and irregularities.

The trustee also asked the trustees under the respective mortgages of the debtor whether they knew of any frauds or irregularities (R. 3905). No information was forthcoming in reply to this inquiry.

The only other matter considered by the trustee was petitioner's charge that debtor had a cause of action against Pacific Fruit Express because of its exorbitant car rental charges. Southern Pacific owns 50% of the

stock of Pacific Fruit Express. The matter is discussed in the trustee's second report, dated February 25, 1938 (R. 3911-15). The trustee concluded that petitioner's contentions as to this were not well founded (R. 3915). The record is to the contrary (R. 5337, 5374-5379).

The succeeding reports of the trustee, insofar as they refer to petitioner's charges, are mere recitals of the results of the proceedings before the Commission and in the District Court.

It is apparent that the trustee's investigations and reports were of a perfunctory nature.

POINT III

Petitioner's motion to remand should have been granted.

On August 23, 1944, the United States instituted suit in the District Court of the United States for the District of Nebraska, Lincoln Division. The complaint in the suit charges a conspiracy under Sections 1 and 2 of the Sherman Antitrust Act. The defendants include The Association of American Railroads; The Western Association of Railway Executives; J. P. Morgan & Company, Incorporated; Kuhn, Loeb & Company; forty-seven Western railroads, constituting all of the important railroads owning lines west of the Mississippi; the Commissioner and Assistant Commissioner under the "Western Agreement"; and some eighty-seven other individuals, officers or directors of The Association of American Railroads or associated with The Western Association of Railway Executives, or members of the Committee of Directors established under the Western Agreement (R. 5380-5440, 5571).

Among the railroads or their respective trustees joined in the Government suit are a number of railroads charged by this petitioner, long previous to the bringing of the

Government suit, as having been implicated in the conspiracy in violation of the antitrust laws, by which control was exercised over debtor to its great damage. These include the Rock Island, in connection with the assertion of the claim against which company in behalf of debtor petitioner has come before this Court (*Meyer* v. *Fleming*, ... U. S. .... (Feb. 4, 1946), Adv. Sheets 90 L. Ed. 422; R. 4823-28); Kansas City Southern, Missouri-Kansas-Texas and the Southern Pacific (R. 341, 363, 3566 *et seq.*).

Petitioner further charged that Union Pacific and Illinois Central were also implicated in said conspiracy. Union Pacific and Illinois Central both participate in traffic routes which are potentially competitive with routes jointly maintained by Southern Pacific and debtor. (R. 3021-38; 4832-65; 743.)

On December 7, 1944, petitioner moved in these proceedings before the Circuit Court of Appeals for a stay, or, in the alternative, for a remand to the District Court with instructions to remand to the Commission (R. 5287-5493). As set forth in the motion (R. 5289):

> "The grounds for asking the relief sought herein are:
>
> "(1) The greatly increased balance of assets over liabilities and the greatly improved financial condition and earnings of the debtor since the supplemental report of the Commission of March 9, 1942; and
>
> "(2) The suit by the Government under the Sherman Antitrust Act against The Association of American Railroads, et al., and the facts revealed by the allegations of the complaint in the said suit and the 'Western Agreement' annexed as an exhibit to the said complaint.
>
> "The said suit constitutes a new development in the affairs of the debtor. In the event of a successful conclusion of the said suit, a change in the relations of the debtor with Southern Pacific and other railroads will

be assured, which will greatly increase debtor's earnings in normal times.

"The facts revealed by the allegations of the complaint in the said suit and the Western Agreement thereto annexed constitute newly discovered evidence relevant and important to the issues herein."

As to the first ground, the debtor's increased assets, improved financial condition and earnings, this is referred to in this brief, *infra*, page 57 .

The second ground consists of two parts: (a) The Government's suit constitutes a new development; and (b) the facts revealed by the complaint and the exhibit annexed thereto constitute newly discovered evidence.

Of these two aspects of the second ground, the Court omits any discussion of the first. It passes only upon the second, holding that the petitioner "had knowledge which would have enabled him to present to the Interstate Commerce Commission, during these proceedings before it, any matters now suggested by this Anti-Trust complaint," and that therefore the matter set forth was not newly discovered evidence (R. 5573).

The motion papers show that petitioner did not have such knowledge.

When, as a director of debtor, petitioner voted for the Western Agreement, he did so upon the representation as to its contents made by Hale Holden, Chairman of Southern Pacific Company. Petitioner had been assured by Holden when he became Chairman of Southern Pacific in July 1932, that he intended to treat debtor fairly (R. 870). Mr. Holden's remarks, at the meeting at which the Agreement was adopted, with respect to the "amicable settlements of differences" (R. 5536) between carriers were taken by petitioner to mean that the purpose of the Western Agreement was to devise arbitration machinery

to avoid the vexations of litigation and to formulate legitimate rules in respect to matters of general railroad practice (R. 5536-5539).

It may be asked, if petitioner had knowledge of the Western Agreement, why he waited until after the Government had instituted suit in August 1944 to use the facts revealed by the Western Agreement in his repeated endeavors to assert the rights and protect the interests of debtor and its security holders.

In March 1934 petitioner brought suit for the benefit of debtor, joining as defendants the Kansas City Southern, Missouri-Kansas-Texas and certain directors of these roads, Southern Pacific, its bankers Kuhn, Loeb & Company, and two of Southern Pacific's directors, deForest and Holden (R. 1011-1013). As appears from the opinions of the District Court and of the Circuit Court of Appeals in that case, no allegation of the bill of complaint was based on the Western Agreement (*Meyer* v. *Kansas City Southern*, 11 F. Supp. 937; aff'd 84 F. (2d) 411, 2d Cir.; cert. denied 299 U. S. 607).

Petitioner did not refer to the Western Agreement in support of his charges of misfeasance in the petition or in the amended petition for investigation in 1937 (R. 339-351, 357-467), or in the hearings before the Commission in 1937 and 1939, or in the District Court hearings in 1942. The fact that petitioner, upon the representation of Holden as to the contents of the Agreement, voted for the Agreement and for deForest, whom he regarded as hostile to debtor, to represent debtor in connection with the carrying out of the Agreement is the best circumstantial proof that petitioner believed that the Agreement was of an entirely innocuous nature.

The Court, in denying the motion, disregarded the principle laid down by the Supreme Court that in reorganization proceedings every important determination by

the court calls for an informed, independent judgment, and that the reorganization court is in a different position from that which it occupies in ordinary litigation where issues are to be determined solely upon such evidence as the contending parties choose to introduce (*Consolidated Rock Products Co.* v. *DuBois,* 312 U. S. 510, 520, 526; *First National Bank* v. *Flershem,* 290 U. S. 504, 525; *National Surety Co.* v. *Coriell,* 280 U. S. 426, 436).

In the suit by the United States under the Sherman Antitrust Act against The American Association of Railroads and others, as petitioner is informed, it has been agreed that counsel for both the Government and the defendants will meet with the Court on January 16, 1947, for the purpose of recommending that the Government be allowed to start putting in its case on April 1, 1947, under a shortened trial technique.

If the Government by a successful termination of the suit, either by trial or by consent decree, breaks up the illegal combination in violation of the antitrust laws, railroads other than Southern Pacific will no longer slow up their traffic routes to accommodate the more circuitous routes of Southern Pacific. Among these circuitous routes is the route maintained jointly by Southern Pacific and the debtor for perishable traffic originating west of El Paso, which traffic is carried by debtor at a heavy loss (R. 3332-46, 5366-74).

Even more important to debtor, Southern Pacific will no longer be under an inducement to solicit traffic for other railroads as a reward for their retardation of deliveries of traffic moving via their routes capable of more expeditious service. This Southern Pacific has done at the expense of its own system long haul, including debtor (R. 5337-51).

Nor will Southern Pacific then be under an inducement to fail to take steps through a lease, and through one-

line solicitation in connection therewith, to obtain greatly increased traffic for debtor (R. 5351-58).

The moving papers show that the Government's suit is of a meritorious nature and that a successful conclusion of that suit will result in adding greatly to debtor's earnings. Even assuming that petitioner had previous knowledge of the Western Agreement and its significance, the many thousands of debtor's security holders should not be made to suffer on that account. The motion should have been granted.

POINT IV

The Circuit Court of Appeals erred in holding that it was within the discretion of Judge Moore to deny petitioner's motion for new hearings.

That a new trial is necessary upon the death or disability of a judge who presided at the trial is a fundamental principle of the common law. *Smith* v. *State of New York,* 214 N. Y. 140, 143-144, Judge Cardozo writing.

In the state courts the following cases, among many others, have applied or recognized the rule: *Guardianship of Sullivan,* 143 Cal. 462, 467; *Wainwright* v. *P. H. & F. M. Roots Co.,* 176 Ind. 682, 698; *Worden* v. *Alexander, et al.,* 108 Mont. 208, 211; *Covaleski* v. *Thomas,* 229 App. Div. (N. Y.) 413, 414; *Company A, First Regiment* v. *State,* 55 N. D. 897, 904; *Commonwealth* v. *Thompson,* 328 Pa. 27, 28-29; *Com. of Pa.* v. *Claney,* 113 Pa. Super. 439, 442, 444. See also *Coleshill* v. *Manchester Corporation* [1928], 1 K. B. 776, 786.

The question presented by the holding of the Circuit Court of Appeals has never been directly passed upon by the Supreme Court.

In *Malony* v. *Adsit,* 175 U. S. 281, it was held that no bill of exceptions could be deemed sufficiently authenticated under Section 953 of the Revised Statutes unless signed by the judge who sat at the trial or by the presiding judge if more than one sat. The Court held that allowing and signing a bill of exceptions was a judicial act which could only be performed by the judge who sat at the trial, stating (p. 284):

> "* * * What took place at the trial, and is a proper subject of exception, can only be judicially known by the judge who has acted in that capacity. Such knowledge cannot be brought to a judge who did not participate in the trial or to a judge who has succeeded to a judge who did, by what purports to be a bill of exceptions, but which has not been signed and allowed by the trial judge."

Shortly after the decision in *Malony* v. *Adsit* the statute was amended so as to permit another judge to hear and pass on a motion for a new trial and to allow and sign a bill of exceptions if the judge before whom the case was tried was "by reason of death, sickness, or other disability" unable to do so. (Act of June 5, 1900, ch. 717, 31 Stat. 270, 28 U. S. C. A. 776.)

The amendment was strictly construed. *Western Dredging & Improvement Co.* v. *Heldmaier* (7th Cir.), 111 F. 123; *Walton* v. *Southern Pac. Co.* (9th Cir.), 53 F. (2d) 63; *Ulmer* v. *United States* (2d Cir.), 266 F. 176.

Rule 63 of the Federal Rules of Civil Procedure has now superseded Section 776 (28 U. S. C. A. 776). It reads:

> "If by reason of death, sickness, or other disability, a judge before whom an action has been tried is unable to perform the duties to be performed by the court under these rules after a verdict is returned or

findings of fact and conclusions of law are filed, then any other judge regularly sitting in or assigned to the court in which the action was tried may perform those duties; but if such other judge is satisfied that he cannot perform those duties because he did not preside at the trial or for any other reason, he may in his discretion grant a new trial."

The only decisions dealing with Rule 63 are two cases in the District Court, *Ten-O-Win Amusement Co.* v. *Casino Theatre* (D. C. Cal. 1942), 2 F. R. D. 242, and *Burrill* v. *Shaughnessy* (D. C., N. D. N. Y., 1946), F. R. Svc. 63.2. In the *Ten-O-Win* case proposed findings and conclusions were unsigned. The successor judge refused to sign them. In the *Burrill* case questions of law were submitted to the trial judge after issues of fact had been determined by the verdict of a jury. He died before rendering a decision. His successor held that he had no power to decide these questions without a retrial.

There are a number of other decisions in the Federal courts on the power of a successor judge to act after the death of the presiding judge. None of these decisions, however, presents facts similar to those in the instant case.

In a very early case, *In re The Life and Fire Ins. Co. of N. Y.* v. *The Heirs of Wilson,* 8 Pet. 291, judgment was rendered and thereafter the judge died. The Supreme Court, citing a statute of Louisiana of 1805 which followed the Spanish law, held that the docketing and signing of the judgment were purely ministerial acts, and that it was not required by the Louisiana statute that the judge who rendered the decision should sign it.

In *Guardian Assur. Co.* v. *Quintana,* 227 U. S. 100, it was held that after verdict had been rendered and the presiding judge passed way, a successor judge could sign the bill of exceptions.

In *Meldrum* v. *United States* (9th Cir.), 151 F. 177; *King* v. *United States* (6th Cir.), 25 F. (2d) 242, and *Missouri State Life Ins. Co.* v. *Langreder* (7th Cir.), 87 F. (2d) 586, it was held that the successor judge had power to act after verdict or after the filing of findings of fact and conclusions of law.

The right to a new trial upon the death or disability of a judge may be waived by stipulation or by conduct that amounts to acquiescence or consent. *Simons* v. *United States* (9th Cir.), 119 F. (2d) 439; *Freeman* v. *United States* (2d Cir.), 227 F. 732; *Thomas-Bonner* v. *Hooven, Owens & Rentschler Co.* (6th Cir.), 284 F. 386.

In *Cahill* v. *Mayflower Bus Lines* (2d Cir.), 77 F. (2d) 838, there was no dispute as to the facts. The only matter that the successor judge had to decide was whether a certain paper constituted sufficient notice.

A judge who merely reads the record is not in as advantageous a position as the trial judge. There are matters transpiring at a trial which do not appear on the record. The trial judge has an opportunity to observe the demeanor of witnesses. He asks questions of counsel and witnesses to inform himself.

Judge Moore was conscious of the difficulties under which he labored as a successor judge (R. 5565). Yet he refused to grant a new trial.

In a case involving the interests of many thousands of security holders, in which there are issues as to the control exercised over debtor in breach of fiduciary obligations and in violations of the antitrust laws, and where the witnesses were hostile, as in the instant case, it was of particular importance that the right to a new trial upon the death of the presiding judge should be safeguarded.

POINT V

The record of earnings of debtor, its increase in assets and in net current assets, and reduction in indebtedness, require a new plan.

In *Group of Investors* v. *Milwaukee R. Co.*, 318 U. S. 523, 540, and in *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510, 526, the Supreme Court dwells upon the importance of earning power in formulating a plan of reorganization.

In 1941 debtor's earnings in net income over and above interest charges amounted to $4,472,048 (R. 5257). The plan was to be effective as of January 1, 1942.

For the following years debtor's net income was as follows: 1942, $5,673,577; 1943, $7,543,273; 1944, $8,119,085 (R. 5257). For the first nine months of 1945 debtor earned in net income $6,507,850. Due to accelerated amortization of defense projects during the last three months, net income for the year amounted to $3,993,006. For the first eleven months of 1946 debtor earned in net income $4,044,435.

Per share of common stock,—which the Commission has held to be valueless,—earnings were as follows: 1941, $20.23; 1942, $27.23; 1943, $38.10; 1944, $41.45; 1945, $17.45; and for the first eleven months of 1946, $18.23 (Moody's Railroads).

Statistics of total operating revenues show that debtor was making better progress in recovering from the depression than other Southwestern railroads, and also as compared with Class I railroads of the country as a whole.

For the three years 1929, 1930 and 1931, the average total operating revenues of debtor, Missouri-Kansas-Texas, St. Louis-San Francisco, Missouri Pacific and Kansas City Southern were as follows (R. 5331):

St. L. S. W.	*M-K-T*	*Frisco*	*Mo. Pac.*	*K. C. S.*
$21,920,433	$45,452,226	$73,477,017	$118,421,266	$18,493,765

Using these respective averages as standards of comparison, for the years 1943 and 1944 total operating revenues of these roads increased in the following percentages (R. 5332, 5544):

	St. L. S. W.	*M-K-T*	*Frisco*	*Mo. Pac.*	*K. C. S.*
1943	193.69	73.86	53.74	92.36	133.70
1944	231.14	84.86	65.01	99.76	139.94

Other comparative figures of operating revenues and of earnings are equally impressive (R. 5330-35; 5544-46).

The superior showing made by the debtor was due in part to the advantageous position it is in to serve the Southern Pacific System, and despite the failure of Southern Pacific to solicit preferentially for debtor (R. 5335).

In 1937 officials of debtor forecast that by 1940 debtor would earn its entire interest charges (R. 221). Income available for fixed charges was estimated at $3,505,000 for 1940, and $4,142,000 for 1941. Interest charges for those years were: 1940, $3,108,980; and 1941, $3,023,893 (R. 5329). The extraordinary earnings during the war period should not be allowed to obscure the fact that in 1937 the management of the debtor was of the opinion, that, assuming normal conditions, debtor would earn in excess of interest charges almost $400,000 in 1940 and $1,000,000 in 1941.

In 1936, the first year of reorganization, when its total operating revenues were $19,363,508, debtor earned 98½% of all its interest charges (R. 5329). For the first eleven months of 1946 total operating revenues were $42,376,393; its net income $4,044,435 (Moody's Railroads)

The Circuit Court of Appeals, referring to debtor's fine record of earnings, states that the "sole cause of

these enormous increases is, for most part if not entirely, the war" (R. 5657). Obviously the war was the cause of a great part of the increase. But the Court erred in disregarding the proof in the record that despite Southern Pacific's failure to carry out its obligations, debtor during the prewar period, as well as during the war has shown a more rapid growth than other railroads, and continues to show large earnings. It must be assumed that the rate of progress shown during the prewar period would have been continued in the absence of abnormal conditions.

The following figures taken from the Annual Reports of debtor show the investment in road and equipment during the years 1942 to 1945, inclusive:

ROAD

	Gross Charges	*Retirements*	*Net*
1942	$1,195,372	$651,161	$544,211
1943	2,274,160	467,984	1,806,176
1944	2,032,801	305,243	1,727,558
1945	2,994,739	1,112,735	1,882,004

EQUIPMENT

	Gross Charges	*Retirements*	*Net*
1942	$1,998,865	$238,175	$1,760,690
1943	622,118	235,545	386,574
1944	2,799,537	309,265	2,490,272
1945	2,531,394	561,631	1,969,763

Total gross expenditures for the four years since the date the plan was to become effective under "Road" amounted to $8,497,072, and under "Equipment" to $7,951,914. After retirements, the net additions and betterments to Road for these years amounted to $5,959,949, and to Equipment $6,607,299.

To the extent that these expenditures contribute to the more efficient and economical operation of the property, it is submitted that they make for increased earnings.

Net current assets as of January 1, 1942, were $2,352,344 (R. 5259, 5261). Net current assets as of October 31, 1946 were $22,090,504 (Dist. Ct. Pr. R. 10578-79), an increase of $19,738,160.

Since January 1, 1942, there has been paid in full the following indebtedness: Equipment Trust Notes, Series K, $216,000; Texarkana Union Station 5% Certificates, $315,000, and Railroad Credit Corporation loan, $1,318,076 (Dist. Ct. Pr. R. 9799, 10429, 10471). There has also been paid on account of the principal of the Stephenville North & South Texas 5% bonds the sum of $76,785 (Annual Reports). There has thus been a reduction in principal since January 1, 1942, of $1,925,861.

Accrued interest as of January 1, 1942, amounted to $14,378,637 (R. 3785). The following table shows that since that date there has been a reduction in accrued interest of $8,281,959.

	Principal Indebtedness Jan. 1, 1942[1]	Accrued Interest Unpaid Jan. 1, 1942[1]	Int. from Jan. 1, 1942, to Jan. 1, 1947	Total Int. as of Jan. 1, 1947	Interest Paid[2]	Interest Unpaid Jan. 1, 1947	Reduction in Acc. Int. Since Jan. 1, 1942
2d Mtge. 4% Certificates.....	$3,042,500	$ 669,350	$ 608,500	$1,277,850	$1,217,000	$ 60,850	$ 608,500
First Terminal & Unifying 5's	8,063,000	2,620,475	2,015,750	4,636,225	4,434,650	201,575	2,418,900
General & Refunding 5's.....	9,327,500	3,031,438	2,331,875	5,363,313	3,264,625	2,098,688	932,750
Stephenville 5's	2,318,448[3]	775,495	563,295	1,338,790	.....	1,338,790	*563,295*
Central Arkansas & Eastern 5's	932,232	335,120	233,058	568,178	.....	568,178	*233,058*
Chase National Bank[4]	3,500,000	1,057,591	875,000	1,932,591	1,742,125	190,466	867,125
Mississippi Valley Trust Co.[5] ..	1,000,000	302,169	250,000	552,169	497,525	54,644	247,525
Southern Pacific Co.[6]	17,882,250	5,573,775	4,470,563	10,044,338	8,460,850	1,583,488	3,990,288
Railroad Credit Corp.[7] ..... (Jan. 31, 1941)	1,318,076	13,224	.....	.....	.....	.....	13,224
						$6,096,679	$8,281,959

[1] Figures for first two columns from R. 3785.

[2] Figures for this column (except Railroad Credit Corporation) computed from R. 5706 *et seq.*

[3] On October 1, 1942, $76,785 was paid, leaving a balance of $2,241,663 (Annual Reports).

[4] Chase National Bank holds as collateral $4,921,500 General & Refunding and $98,000 Southern Illinois & Missouri Bridge Co. bonds. Accrued interest paid on the General & Refunding bonds amounted to $1,722,525. Interest paid on the Bridge Co. bonds amounted to $19,600, a total of $1,742,125.

[5] Mississippi Valley Trust Company holds as collateral $1,405,500 General & Refunding bonds and $28,000 Bridge Co. bonds. Accrued interest on the General & Refunding bonds amounted to $491,925, interest on the Bridge Co. bonds $5,600, a total of $497,525.

[6] Southern Pacific Company holds as collateral $23,903,000 General & Refunding bonds and $474,000 Bridge Co. bonds. Accrued interest on the General & Refunding bonds amounted to $8,365,050, interest on the Bridge Co. bonds $94,800, a total of $8,460,850.

[7] Principal and interest on the Railroad Credit Corporation loan have been paid (District Ct. Printed Record p. 10471).

Total reduction in principal and accrued interest amounts to $10,207,820. The plan fails to provide for indebtedness to the extent of $8,243,764 (R. 3782). The reduction in principal and accrued interest alone is thus $1,964,056 in excess of such indebtedness.

Of the $22,090,504 of net current assets, $17,000,000 could readily be used to make further reductions in debt. The bond issues and loans which could be paid off bear interest at the rate of 5% with the exception of the Second Mortgage 4% bonds. If the $17,000,000 were so used, there would be a reduction of interest charges in the amount of $818,575. The large amount of cash in debtor's treasury, viewed from this standpoint, carries with it an annual increase in net income of over $800,000 per annum.

Debtor's principal indebtedness as of January 1, 1942, amounted to $68,865,006, and with accrued interest to $83,243,643 (R. 3785). If present indebtedness were reduced by $17,000,000, this would make a total reduction from the January 1, 1942, figure of $27,207,820, or 32.7%.

Other developments that the Commission was not in a position to anticipate at the time of the formulation of the plan and which will make for a large net income are: (1) the recent increase in freight rates of 17.6% granted by the Commission; (2) the high level of productivity of the country as a whole, both in dollar value and in units of production; and (3) the assurance that low interest rates are to continue, thus enabling the railroads to refinance on an advantageous basis.

The territory served by Southern Pacific System includes the states of Louisiana, Texas, California, New Mexico and Arizona, which during the years 1930 to 1940, and since then, have shown a growth greater than other regions. In view of the strategic position of debtor to serve other parts of Southern Pacific System, any growth

in population and progress in the development of the territory served should be reflected in an accentuated form in freight revenues of the debtor.

The Supreme Court in the *Denver & Rio Grande* case held that the changed conditions under the circumstances of that case did not require a new plan. The plan was dated June 1943. The earnings of the Company for the following years were: 1941, *d* $2,301,914; 1942, $11,306,966; 1943, $5,907,760; 1944, $2,505,572; 1945, *d* $7,139,492; 1946, to November 30, *d* $2,422,014 (Moody's Railroads).

As the Supreme Court pointed out, the best year that the Denver & Rio Grande had was the year preceding the formulation of the plan.

In the instant case, debtor's earnings, after the formulation of the plan in March, 1942, and during each of the war years, were substantially greater than they were during the year 1941. During the postwar period earnings have been excellent.

In this and other ways, the facts in the case of debtor are very different from those in the *Denver & Rio Grande* case.

In determining that the plan eliminating the stockholders of debtor was not arbitrary, the Circuit Court of Appeals discusses two matters (R. 5669). In connection with the first,—that junior indebtedness in the amount of $8,304,118 was unprovided for,—regard should be had to the fact that principal and accrued interest has been reduced since January 1, 1942, in excess of that amount and there is now a large sum available for further reduction of debts.

The second matter was that in the opinion of the Court the indebtedness to Southern Pacific Company and the banks was greater by $11,901,130 than the total of the respective claims, being the difference between the face value of the claims with interest and the par value of the col-

lateral with interest given as security. The Court states (R. 5670): "The participation in the Plan allowed these three creditors seems to be based on the value of pledged security rather than face of loans plus accrued interest."

In holding that the loans were undervalued, the Court referred to *In re Chicago & N. W. Ry. Co.*, 7 Cir., 126 F. (2d) 351, cer. den. 318 U. S. 793, and *In re New York, New Haven & Hartford R. Co.*, 2 Cir., 147 F. (2d) 40, 47-48, cer. den. 325 U. S. 884.

The cases cited do not support the Court's theory that there has been an undervaluation of the indebtedness to Southern Pacific and the banks.

In the *New Haven* case, *supra*, it was held that the banks were entitled to be treated "as secured creditors to the extent to which they could have realized on their collateral had they not been restrained from selling, and as unsecured creditors only for the amount by which the debts owing them exceed such realizable value of the collateral" (p. 48).

In *In re Chicago & N. W. Ry. Co., supra*, the Court held that in view of the fact that the Reconstruction Finance Corporation held collateral through a sale of which it could have realized the full amount of its claim, this was a circumstance to be taken into consideration in determining whether in the plan of reorganization the R.F.C. had been unduly favored (p. 369).

It is apparent from both of these cases that, insofar as claims are secured, their value as such is to be measured by the market value of the collateral at the time of the filing of the petition for reorganization.

On December 12, 1935, an injunction was issued restraining the creditors of debtor from selling or otherwise disposing of the collateral held by them respectively (R. 57).

The General & Refunding 5's during the period December 12 to December 27, 1935, sold at a high-low of 28½-23½

(R. 233). Southern Illinois & Missouri Bridge Company bonds sold at a high for 1935 of 74½ (R. 235). On the basis of 28½ for the General & Refunding 5's and 74½ for the Bridge Company bonds, the total value of the collateral held by Southern Pacific Company on December 12, 1935 was $7,165,485.

If the measure of a secured claim is the market price of the collateral, then Southern Pacific, for example, was entitled to be treated as a secured creditor only to the extent of $7,165,485 of its claim of $17,882,250.

In view of the *New Haven* and *Chicago & N. W.* cases, the Court erred in holding that the claims of Southern Pacific and the banks had been undervalued to the extent of $11,901,130.

CONCLUSION

It is respectfully submitted that a writ of certiorari should be granted.

Dated: New York, January 17, 1947.

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And as Attorney for other Stockholders.

R. WALSTON CHUBB,
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Appendix

The pertinent provisions of Section 77 of the Bankruptcy Act (11 U. S. C. A. 205) are as follows:

"(b) A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; (2) may include provisions modifying or altering the rights of stockholders generally, or of any class of them, either through the issuance of new securities of any character, or otherwise; (3) may include, for the purpose of preserving such interests of creditors and stockholders as are not otherwise provided for, provisions for the issuance to any such creditor or stockholder of options or warrants to receive, or to subscribe for, securities of the reorganized company in such amounts and upon such terms and conditions as may be set forth in the plan; (4) shall provide for fixed charges (including fixed interest on funded debt, interest on unfunded debt, amortization of discount on funded debt, and rent for leased railroads) in such an amount that, after due consideration of the probable prospective earnings of the property in light of its earnings experience and all other relevant facts, there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof; * * *

* * * * *

"(c) After approving the petition:

* * * * * *

"(9) The judge shall direct the trustee or trustees, and may request the Commission through such of its agencies as it may designate, to report to him any facts pertaining to irregularities, fraud, misconduct, or mis-

management, as a consequence of which the debtor may have a cause of action arising therefrom against any person or corporation.

* * * * *

"(d) The debtor, after a petition is filed as provided in subsection (a) of this section, shall file a plan of reorganization within six months of the entry of the order by the judge approving the petition as properly filed, * * * After the filing of such a plan, the Commission, unless such plan shall be considered by it to be prima facie impracticable, shall, after due notice to all stockholders and creditors given in such manner as it shall determine, hold public hearings, at which opportunity shall be given to any interested party to be heard, and following which the Commission shall render a report and order in which it shall approve a plan, which may be different from any which has been proposed, that will in its opinion meet with the requirements of subsections (b) and (e) of this section, and will be compatible with the public interest; or it shall render a report and order in which it shall refuse to approve any plan. In such report the Commission shall state fully the reasons for its conclusions.

* * * * *

"(e) Upon the certification of a plan by the Commission to the court, the court shall give due notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the

plan and such claims for equitable treatment. After such hearing, and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; * * *

"If the judge shall not approve the plan, he shall file an opinion, stating his conclusions and the reason therefor, and he shall enter an order in which he may either dismiss the proceedings, or in his discretion and on motion of any party in interest refer the proceedings back to the Commission for further action, in which event he shall transmit to the Commission a copy of any evidence received. * * * If the judge shall approve the plan, he shall file an opinion, stating his conclusions and the reasons therefor, and enter an order to that effect, and shall send a certified copy of such opinion and order to the Commission. The plan shall then be submitted by the Commission to the creditors of each class whose claims have been filed and allowed in accordance with the requirements of subsection (c) of this section, and to the stockholders of each class, and/or to the committees or other representatives thereof, for acceptance or rejection, within such time as the Commission shall specify, together with the report or reports of the Commission thereon or such a summarization thereof as the Commission may approve, and the opinion and order of the judge: *Provided,* That submission to any class of stockholders shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, (a) that at the time of the finding the corporation is insolvent, or that at the time of the finding the equity of such class of stockholders has no

value, or that the plan provides for the payment in cash to such class of stockholders of an amount not less than the value of their equity, if any, * * * *Provided further,* That submission to any class of creditors shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, that the interests of such class of creditors will not be adversely and materially affected by the plan, or that at the time of the finding the interests of such class of creditors have no value, or that the plan provides for the payment in cash to such class of creditors of an amount not less than the value of their interests. * * *

"If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts."